

REPORT OF EXAMINATION  
OF THE  
CALIFORNIA GENERAL UNDERWRITERS  
INSURANCE COMPANY, INC.

AS OF  
DECEMBER 31, 2003

## TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
COMPANY HISTORY .....	2
MANAGEMENT AND CONTROL: .....	2
Management Agreements .....	5
TERRITORY AND PLAN OF OPERATION .....	5
REINSURANCE: .....	6
Assumed.....	6
Ceded .....	6
ACCOUNTS AND RECORDS .....	6
FINANCIAL STATEMENTS:.....	6
Statement of Financial Condition as of December 31, 2003 .....	7
Underwriting and Investment Exhibit for the Year Ended December 31, 2003.....	8
Reconciliation of Surplus as Regards Policyholders from December 31, 2000 through December 31, 2003.....	9
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	10
Bonds, Stocks and Cash and Short-Term Investments .....	10
Losses and Loss Adjustment Expenses .....	10
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	10
Current Report of Examination.....	10
Previous Report of Examination .....	11
ACKNOWLEDGEMENT .....	12

Los Angeles, California  
October 22, 2004

Honorable John Garamendi  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA GENERAL UNDERWRITERS INSURANCE COMPANY, INC.

(hereinafter also referred to as the Company) at its branch office located at 4484 Wilshire Boulevard, Los Angeles, California 90010. The Company's statutory home office is located at 555 West Imperial Highway, Brea, California 92821.

#### SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2000. This examination covers the period from January 1, 2001 through December 31, 2003. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

This examination was conducted concurrently with examinations of the Company's parent, Mercury Casualty Company, and its affiliates, Mercury Insurance Company, and California Automobile Insurance Company.

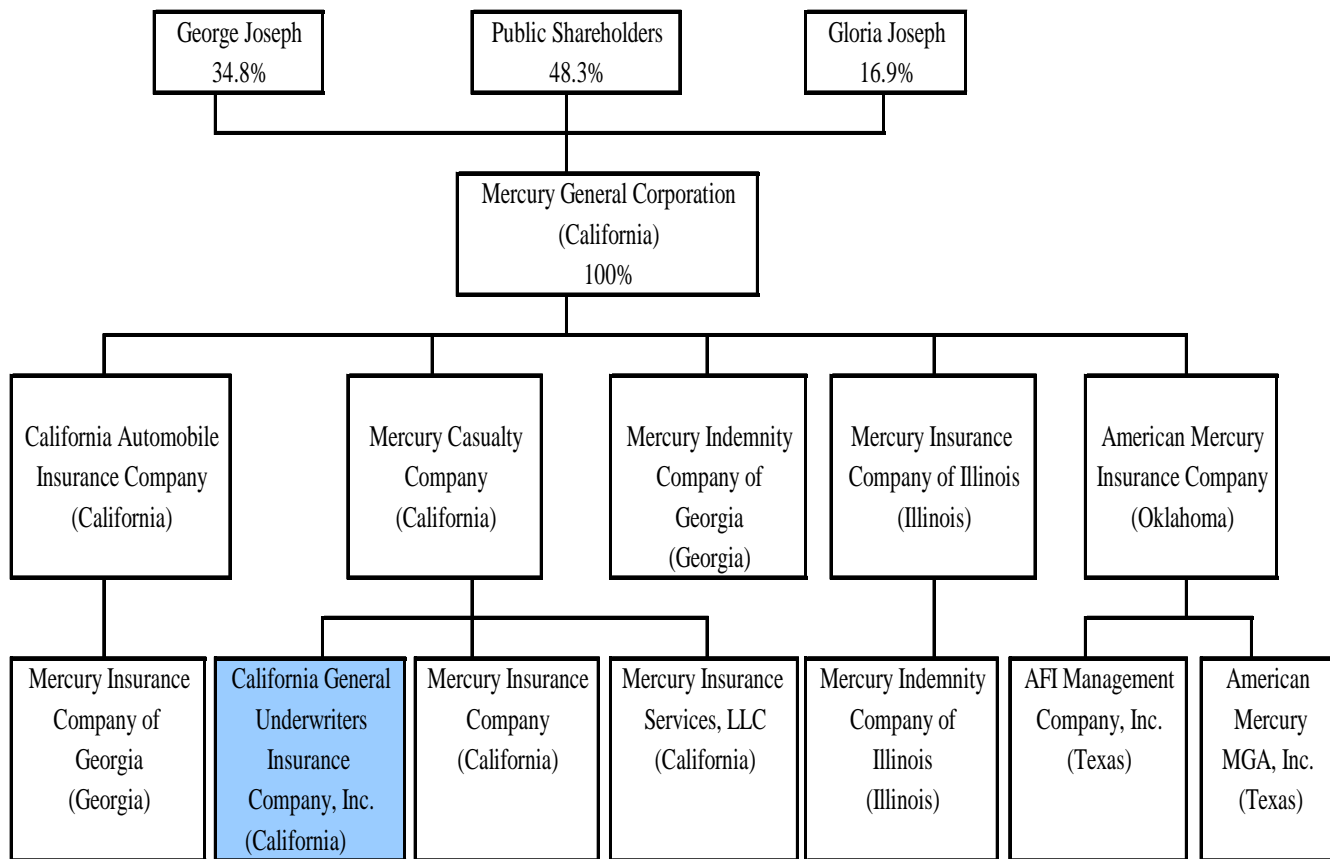
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

### COMPANY HISTORY

The Company was incorporated under the laws of the State of California on April 15, 1985, and commenced business on July 1, 1999.

### MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Mercury Casualty Company (MCC). MCC, in turn, is a wholly-owned subsidiary of Mercury General Corporation (MGC), a holding company. The controlling stockholders, George Joseph and Gloria Joseph, own 34.8% and 16.9%, respectively, of the stock of MGC, with the remaining 48.3% held by public shareholders. The following organizational chart depicts the interrelationships of the companies within the holding company system:



Management of the Company is vested in a ten-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2003 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Nathan Bessin Los Angeles, California	Senior Partner J. Arthur Greenfield & Company
Bruce A. Bunner Weston, Connecticut	President Financial Structures, Ltd.
Michael D. Curtius Carlsbad, California	Executive Consultant Mercury General Corporation
Richard E. Grayson Murrieta, California	Retired
George Joseph Los Angeles, California	Chairman and Chief Executive Officer Mercury General Corporation
Charles E. McClung Carlsbad, California	Chairman McClung Insurance Agency
Donald P. Newell Rancho Santa Fe, California	Senior Vice President and Secretary SCPIE Holdings, Inc.
Bruce E. Norman Los Angeles, California	Vice President, Marketing Mercury General Corporation
Donald R. Spuehler Los Angeles, California	Retired Partner Law Firm of O'Melveny & Meyers, LLP
Gabriel Tirador Los Angeles, California	President Mercury General Corporation

## Principal Officers

<u>Name</u>	<u>Title</u>
George Joseph	Chairman, Chief Executive Officer and Treasurer
Gabriel Tirador	President
Cooper Blanton, Jr.	Executive Vice President
Judy Walters	Vice President, Corporate Affairs and Corporate Secretary
Theodore Stalick	Vice President and Chief Financial Officer

## Management Agreements

Management Agreement: The Company operates under a management agreement with Mercury Insurance Services, LLC (MIS), a subsidiary of Mercury Casualty Company. Prior to January 1, 2001, these services were provided by Mercury General Corporation. Under this agreement, MIS performs all operating functions such as marketing, underwriting, rating, policy issuance, claims, data processing, and pays all the operating expenses including, but not limited to rent, supplies, salaries, legal and claim adjustment expenses. The Company directly pays for losses, premium taxes, audit fees, and various fees and assessments. Management fees are based on actual expenses incurred for services provided to the Company. The California Department of Insurance approved this agreement on January 1, 2001. During the examination period, no costs were incurred under the terms of this agreement.

Tax Allocation Agreement: The Company and its parent file a consolidated federal income tax return under the terms of a Tax Allocation Agreement. The Company's tax liability, under the terms of this agreement, is the same as it would have been had it filed on a separate stand-alone basis.

## TERRITORY AND PLAN OF OPERATION

The Company is licensed as a multiple line fire and casualty insurer in the State of California, however, no direct business was written during the examination period.

## REINSURANCE

### Assumed

Effective July 1, 1999, the Company entered into a reinsurance agreement with its parent, Mercury Casualty Company. Under the terms of the agreement, the Company assumed all of the automobile fleet policies inforce or written by Mercury Casualty Company on or after July 1, 1999. Underwriting expenses incurred relating to the fleet policies, including commissions, premium taxes, and other underwriting expenses, were also assumed from Mercury Casualty Company.

### Ceded

The Company did not cede any reinsurance business during the period covered by the examination.

## ACCOUNTS AND RECORDS

This examination experienced some minor difficulties obtaining supporting documentation for certain balance sheet accounts. It is recommended that the Company maintain documentation to support all financial statement accounts. The documentation should be prepared in sufficient detail as to allow for a full and complete audit trail from the Annual Statement to individual record.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2000 through December 31, 2003



Statement of Financial Condition  
as of December 31, 2003

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 10,883,349	\$	\$ 10,883,349	(1)
Cash and short-term investments	1,573,820		1,573,820	(1)
Investment income due and accrued	175,826		175,826	
Net deferred tax asset	<u>7,923</u>	<u>3,169</u>	<u>4,754</u>	
Total assets	<u>\$ 12,640,918</u>	<u>\$ 3,169</u>	<u>\$ 12,637,749</u>	

Liabilities, Surplus and Other Funds

Losses		\$ 170,003	(2)
Loss adjustment expenses		71,122	(2)
Commissions payable, contingent commissions		51,001	
Current federal and foreign income taxes		29,000	
Ceded reinsurance premiums payable		1,490	
Payable to parent, subsidiaries and affiliates		<u>917</u>	
Total liabilities		323,533	
Common capital stock	\$ 4,000,000		
Gross paid-in and contributed surplus	3,500,000		
Unassigned funds (surplus)	<u>4,814,216</u>		
Surplus as regards policyholders		<u>12,314,216</u>	
Total liabilities, surplus and other funds		<u>\$ 12,637,749</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2003

Statement of Income

Underwriting Income

Premiums earned		\$ 393,390
Deductions:		
Losses incurred	\$ 219,936	
Loss expense incurred	48,795	
Other underwriting expenses incurred	<u>87,219</u>	
Total underwriting deductions		<u>355,950</u>
Net underwriting gain		37,440

Investment Income

Net investment income earned	\$ 544,479	
Net realized capital losses	<u>(17,573)</u>	
Net investment gain		<u>526,906</u>
Net income before federal income taxes		564,346
Federal income taxes incurred		<u>14,000</u>
Net income		<u>\$ 578,346</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002		\$ 11,720,336
Net income	\$ 578,346	
Change in net unrealized capital gain	7,678	
Change in net deferred income tax	(49,828)	
Change in nonadmitted assets	<u>57,684</u>	
Change in surplus as regards policyholders		<u>593,880</u>
Surplus as regards policyholders, December 31, 2003		<u>\$ 12,314,216</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2000 through December 31, 2003

Surplus as regards policyholders, December 31, 2000, per Examination			\$ 10,316,943
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 1,966,530	\$	
Net unrealized capital gains	16,893		
Change in net deferred income tax		13,462	
Change in nonadmitted assets	18,349		
Cumulative effect of changes in accounting principles	<u>8,963</u>		
Totals	<u>\$ 2,010,735</u>	<u>\$ 13,462</u>	
Net increase in surplus as regards policyholders			<u>1,997,273</u>
Surplus as regards policyholders, December 31, 2003, per Examination			<u>\$ 12,314,216</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Bonds, Stocks and Cash and Short-Term Investments

Effective September 3, 2003, the Company terminated its Custodial agreement, and replaced it with a new Custodial agreement. The new agreement is between the Company and BNY Western Trust Company. The Company failed to submit this agreement to the California Department of Insurance (CDI) for review and approval under California Insurance Code (CIC) Section 1104.9. It is recommended that the Company submit this agreement to the CDI for review and approval pursuant to CIC Section 1104.9.

### (2) Losses and Loss Adjustment Expenses

The December 31, 2003 for loss and loss adjustment expense reserves were evaluated by a Casualty Actuary from the California Department of Insurance. Based on the analysis performed, the Company's reserve for loss and loss adjustment expense reserves as of December 31, 2003 were deemed reasonable.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records (Page 6): It is recommended that the Company maintain documentation to support all financial statement accounts.

Bonds, Stocks and Cash and Short-Term Investments (Page 10): It is recommended that the Company implement procedures to ensure compliance with California Insurance Code (CIC) Sections 1104.9 and 1215.

### Previous Report of Examination

Corporate Records (Page 5): It was recommended that the Company comply with the CIC Section 735 which requires the Company to inform the board members of the receipt of the examination report and enter that fact in the board minutes. The Company complied with this recommendation.

### ACKNOWLEDGEMENT

The courtesy and cooperation extended by the officers and employees of Mercury Insurance Services, LLC during the course of this examination are hereby acknowledged.

Respectfully submitted,

---

Duane Armstrong, CFE  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California